

ROUTING AND TRANSMITTAL SLIP		Date
		19 Aug 1986
TO: (Name, office symbol, room number, building, Agency/Post)		Initials Date
1. DDI		<i>[Signature]</i>
2. <i>2A</i> DCI		<i>[Signature]</i>
3. <i>DCI - Hold for</i>		<i>15 SEP 1986</i>
4.		
5.		
Action	File	Note and Return
Approval	For Clearance	Per Conversation
As Requested	For Correction	Prepare Reply
Circulate	For Your Information	See Me
Comment	Investigate	Signature
Coordination	Justify	
REMARKS		

DO NOT use this form as a RECORD of approvals, concurrences, disposals, clearances, and similar actions

FROM: (Name, org. symbol, Agency/Post) Room No.—Bldg.

4E58 HQ

9041-102

☆ GPO : 1983 O - 381-529 (301)

STAT

**Memorandum for:** DCI

DDI

DDI- 03875X/86

**SUBJECT:** The Soviet Economy

Attached are comments on the recent Post article by Jan Vanous of PlanEcon which describe bleak Soviet economic prospects resulting from declining hard currency earnings. In our view, the assessment of the Soviet economic outlook in the article is overly negative and fails to take account of factors which have an important bearing on the situation. This article places Vanous with Harry Rowen and other outside economists who conclude the Soviet economic situation is extremely serious. We agree that the Soviet economy has problems, but our analysis shows the economy remains viable. Indeed its performance has improved in the last year or so. More importantly, we do not agree with Rowen, Vanous, and others that Soviet economic problems will force Gorbachev to conclude arms control agreements.



Douglas J. MacEachin

Director,

**SOVA**  
Office of Soviet Analysis

STAT

SECRET [REDACTED]

Comments on Washington Post Article on Soviet Economic Prospects

1. An article in the 17 August 1986 Post's Outlook section by PlanEcon's research director, Jan Vanous, paints a dark picture of Soviet economic prospects as a result of declining hard currency earnings. [REDACTED]

25X1  
25X1  
25X1

[REDACTED] We think Vanous does not make sufficient allowance for the full range of policy options available to the Soviets. We also question his interpretation of current Soviet trade policy and the role of trade in the domestic economy, which results in an extremely negative assessment of Soviet economic prospects. [REDACTED]

25X1

2. Central to Vanous' thesis is his calculation that the Soviets will have to borrow about \$25 billion from the West over the next five years just to maintain "reasonable" levels of hard-currency imports and that even with this level the USSR will not be able to meet its modernization goals.

- A more realistic borrowing rate, we believe, would be about \$1-2 billion per year over the next several years--less than half the rate Vanous describes as essential for "reasonable" levels of hard currency imports. This borrowing rate is likely to be combined with increased gold sales and drawing down of the USSR's large cushion of assets.
- Even with these measures, however, hard currency import capacity probably will fall during the 1985-90 period--perhaps by as much as one-third from the 1984 level. [REDACTED]

25X1

3. The question is, would such a drop be so "unreasonable" as to force the Soviets to break with their long standing policy against high debt service or face the drastic consequences that Vanous describes?

- Our assessment is that a one-third cut in imports, while painful, need not be as disastrous as Vanous states. Agricultural imports could absorb a major part of the reduction, given a scenario of average weather, improved agricultural practices, and the continued world grain glut which increases Moscow's purchasing power for grain imports (the latter point ignored by Vanous). Even if total hard currency agricultural imports were cut by 50 percent from the 1981-85 level, we estimate that some growth in farm products per capita would still be possible, although at rates below the 1986-90 goals.
- Even with a one-third cut in imports the Soviets will have enough hard currency to preserve imports of the most essential kinds of Western machinery and technology such as energy-related equipment and advanced machine tools.

SECRET [REDACTED]

25X1

SECRET [REDACTED]

25X1

- Moreover, the Soviets have some flexibility in reducing the impact of necessary cuts in machinery imports. They could push for more buyback and barter arrangements. Also, expensive, turnkey projects could be scaled back, with the Soviets providing more of the civil engineering work, equipment and plant infrastructure themselves. [REDACTED]

25X1

4. Vanous believes that the cutback in import capacity will be so damaging to the economy because he assumes that the 1986-90 plan includes a large projected increase in imports of Western machinery. This is debatable. The Soviets have been restrained in their statements about the prospects for East-West trade, and Gorbachev has continued to emphasize the importance of developing domestic capabilities and increasing intra-CEMA trade and cooperation. [REDACTED]

25X1

5. Moreover [REDACTED] there are many exogenous and endogenous events that could have a critical impact on the situation. For example, a further slide in oil prices and/or adverse weather would certainly force the regime to make the tough choices outlined by Vanous about the relative priorities of its modernization and consumer goals--by the late 1980s if not now. Internal chaos in South Africa, on the other hand, which disrupts supplies on international markets of gold, diamonds, and platinum-group metals and raises prices, could boost Soviet import capacity substantially. Vanous never attempts to impress upon his readership the number and size of the variables involved which might produce other outcomes. [REDACTED]

25X1

25X1

6. Vanous' conclusions about the impact on the military are also more extreme than ours. He asserts that the downward slide of exports and imports will force Gorbachev to "slash" procurement of military hardware to free up the machinery resources needed to fulfill his modernization plans. According to analysis prepared by Vanous and his associates at PlanEcon, Gorbachev must limit growth of military procurement expenditures to no more than one-half the rate PlanEcon estimates prevailed during the seventies and early eighties. Our estimate--measured in constant prices, as opposed to the prices which Vanous uses--shows no growth in procurement spending from the mid-1970s to the present, and projected growth of about 1 percent each year through 1990. [REDACTED]

25X1  
25X1

7. While we agree with Vanous that in order for Gorbachev to achieve his modernization goals military spending will need to be constrained during 1986-90, we find fault with the methods he uses to reach this conclusion and disagree with his assertion that procurement spending must be cut substantially from recent levels.

- Vanous relies on published Soviet economic data to derive his estimates and projections of spending for military procurement. Because of the uncertainties associated with the interpretation of Soviet data, Vanous grievously overstates the accuracy of his work. In a recent technical report, we demonstrated that the technique used by Vanous in deriving

SECRET [REDACTED]

25X1

SECRET 

25X1

military hardware procurement is invalid.\* We found that simply adjusting for data uncertainties and methodological inconsistencies resulted in a tremendous range in both the levels and growth rates of his estimate of military hardware expenditures.

- Vanous' estimates of future levels of procurement spending depend on his historical series, which--as indicated above--are subject to a high degree of uncertainty. Moreover, in order to formulate his projections, Vanous made a number of assumptions about future investment and output patterns that are also highly uncertain. For these reasons alone, the degree of confidence Vanous associates with his projections is completely unfounded.

25X1

25X1SECRET 

25X1

SECRET

25X1

SUBJECT: Comments on Washington Post Article on Soviet Economic Prospects

Distribution:

1 -- DCI  
1 -- DDCI  
1 -- DDI  
1 -- NIO/USSR  
1 -- NIO/SP  
1 -- C/ACIS  
1 -- D/EURA  
1 -- D/OGI  
1 -- D/OSWR  
1 -- D/OIA  
1 -- D/LDA  
1 -- D/SOVA  
1 -- DD/SOVA  
1 -- C/SOVA/DEIG  
1 -- DC/SOVA/DEIG  
1 -- C/SOVA/NIG  
1 -- DC/SOVA/NIG  
1 -- C/SOVA/DEIG/DED  
1 -- C/SOVA/DEIG/DID

DDI/SOVA/DEIG/DED/

19 August 1986)

25X1

SECRET

25X1